Air Force Materiel Command

Pricing Fixed Price Incentive Firm (FPIF) Contracts

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Outline

- **Section 1: Basics of FPIF contracts**
- **Section 2: How to Build a Bottoms-Up FPIF Geometry**
- **Section 3: How to use the AFMC model to build a Bottoms-up FPIF position**
- **Section 4: Negotiation Tips**
- **Section 5: Administrative Considerations (Pricing Perspective)**
- **Section 6: FPIF in Competitive Environment**

Section 1

The Basics of FPIF Contracts

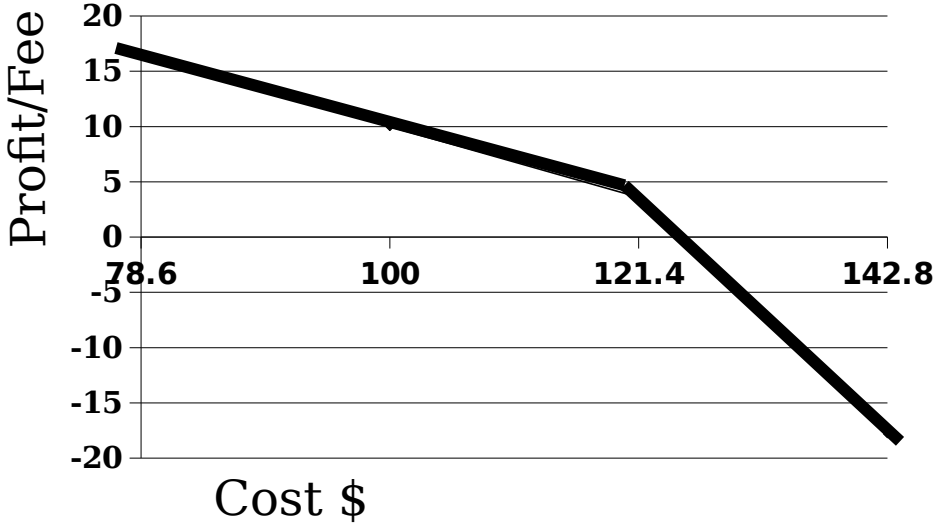
The Basics of FPIF Contracts

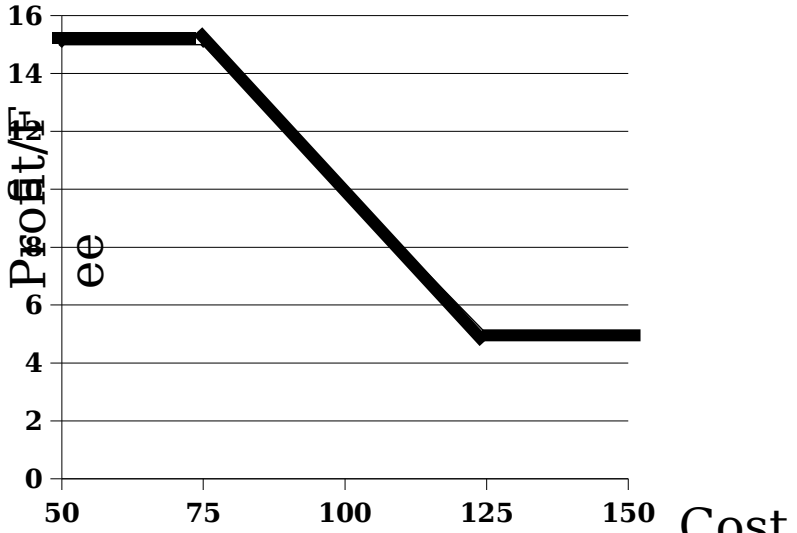
- **Type of Fixed Price contract**
  - **High confidence that technical performance can be achieved and technical and cost risk can reasonably be evaluated in terms of risk to the contractor**
  - **Provides for adjusting profit and establishing final contract price by application of a formula based on the relationship of total final negotiated cost to total target cost**
    - Uses profit sharing formula to motivate contractor to control costs
  - **Final price is subject to a price ceiling**
    - Ceiling price can be established that covers most probable risks inherent in nature of work
- **FPIF should be considered during acquisition planning as opposed to after the proposal comes in (although still may be possible to utilize)**
- **Use of FPIF for production efforts**
  - **PGI 216.403-1(1)(ii)(B) FPIF contracts should be considered in production programs where actual costs on prior FFP contracts have varied by more than *four percent* from the costs considered negotiated**

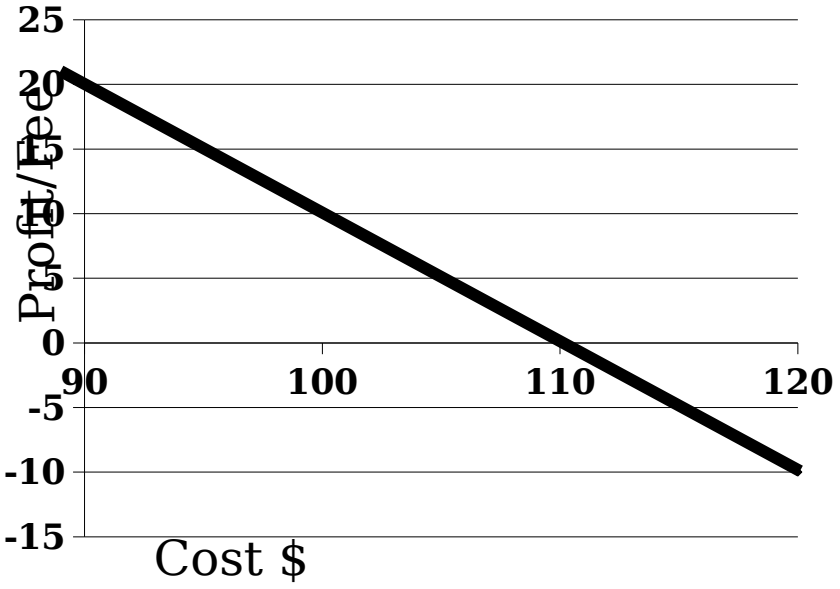
The Basics of FPIF Contracts

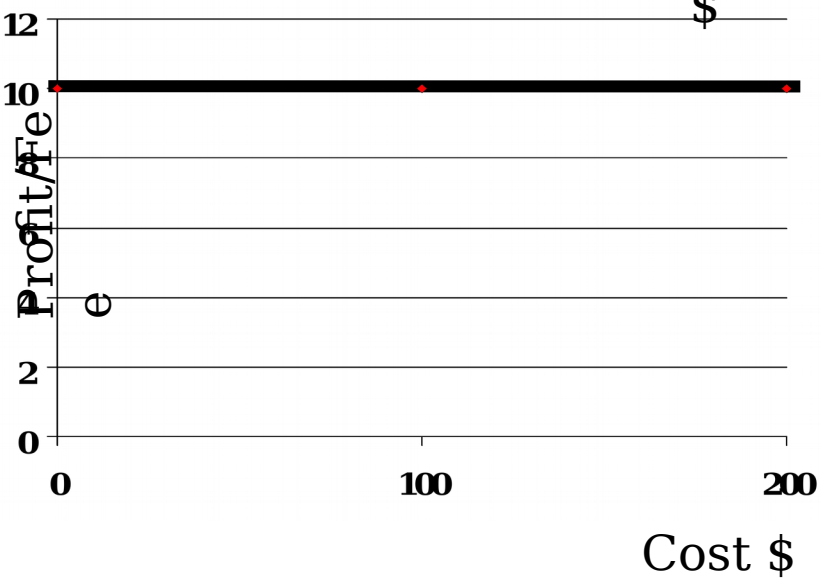
- **In Sole Source, FPIF discussion is about**
  - Dealing with differences in cost
    - In Peer Reviews, when there are large differences between proposed and objective, FPIF may be a topic of discussion
    - Profit is not a bad thing, but excessive profits due to inadequate cost estimates are not necessarily a good thing
    - Ability to negotiate commensurate with recent actual costs
    - FPIF can be a vehicle to help close the deal
  - Getting cost insight at the end of the day
  - Ok for Government to get something back when the company underruns
  - FPIF does not have to have ceiling coverage
    - Effectively, this is FFP with underrun sharing - keep that in mind when you are deciding what type of WGL to run

NAME THAT CONTRACT TYPE

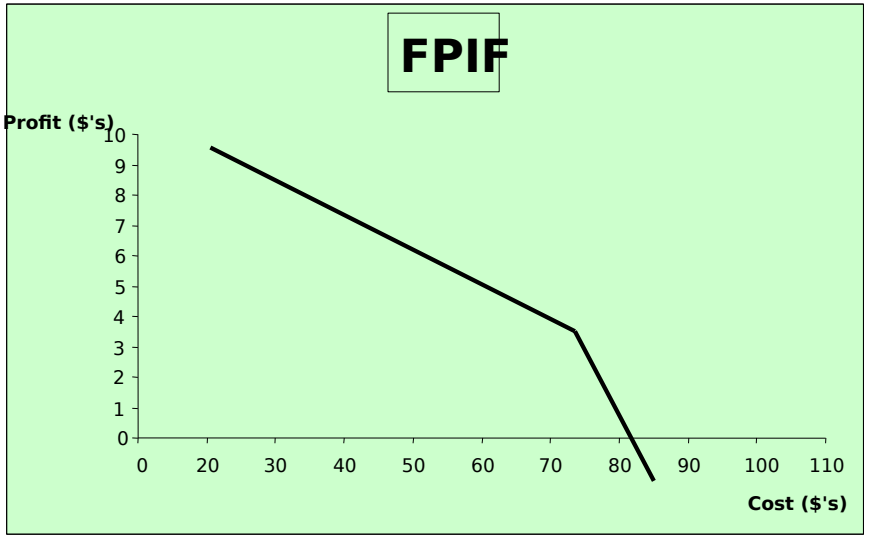






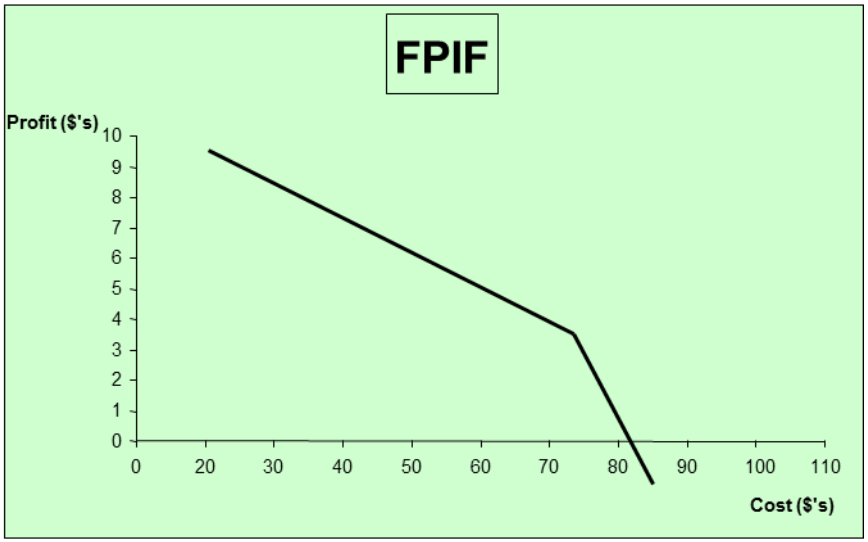


Goodness of FPIF from USG Point of View



- As cost decreases, price to Government decreases
- Contractor is incentivized via additional profit to decrease costs
- The Ceiling limits the Government’s exposure

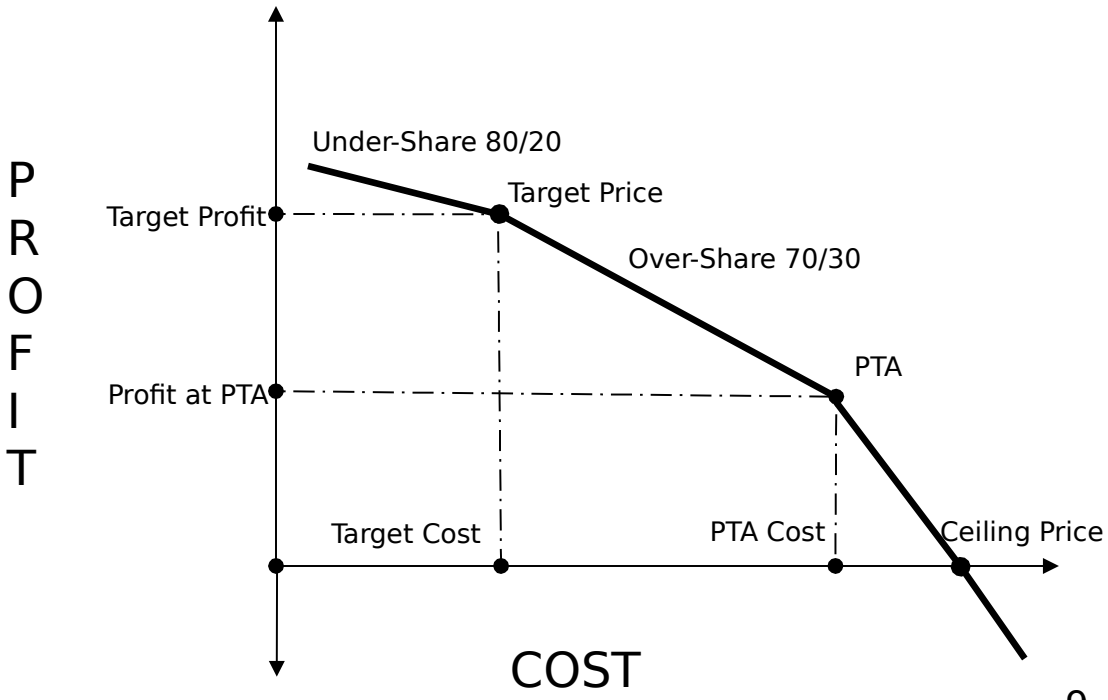
Goodness of FPIF from Contractor Point of View



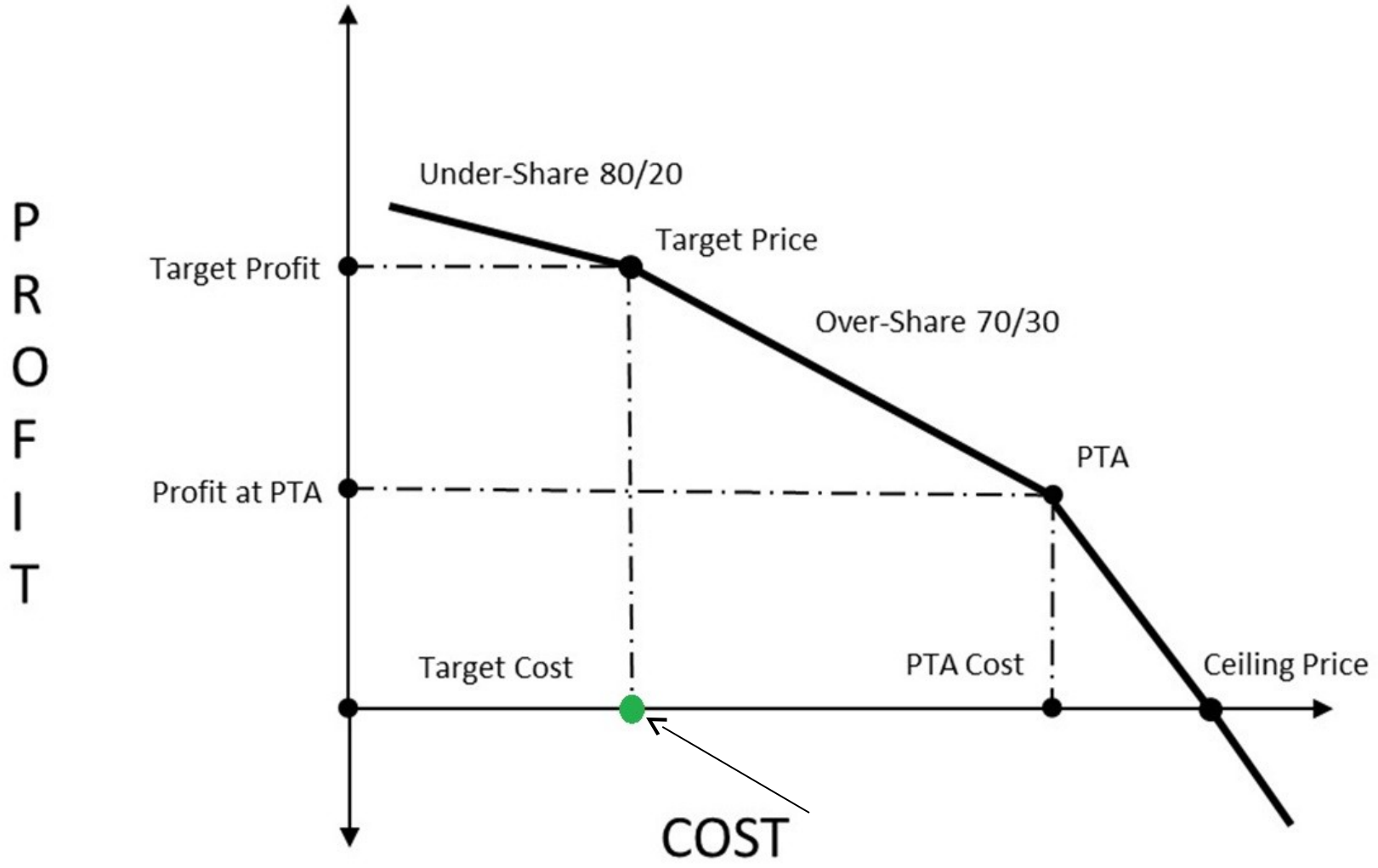
- Contractor can increase profit dollars and profit percentage by reducing cost below target cost
- Ceiling coverage above target price provides risk mitigation to the contractor

FPIF Geometry

- **Target Cost**
- **Target Profit**
- **Point of Total Assumption (PTA)**
- **Share Ratios**
- **Ceiling Price**



FPIF – Target Cost

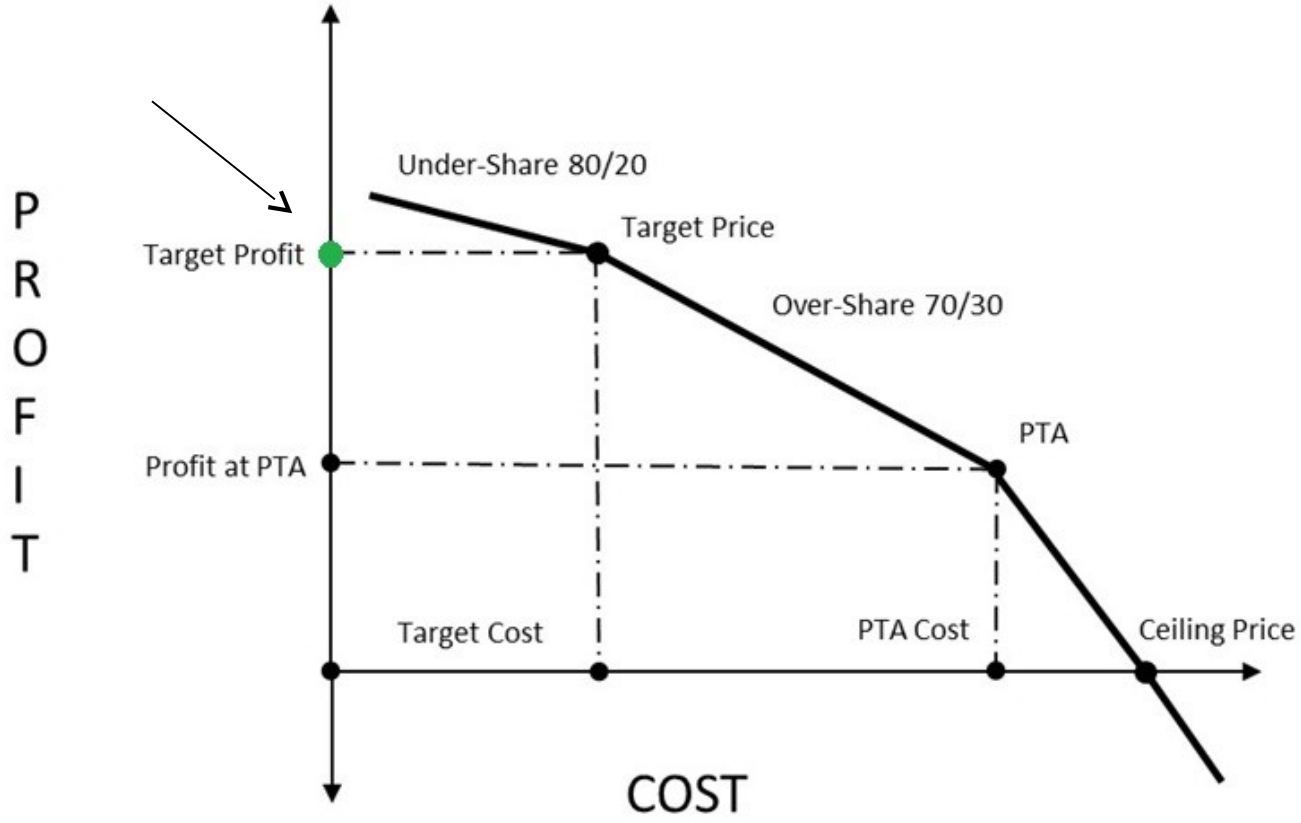


FPIF – Target Cost

- **Target cost is built from:**
  - **Technical Evaluation**
  - **DCAA Audit Report**
  - **DCMA FPRR/FPRA**
  - **PCO Analysis**
- **A good target cost position should be reasonably challenging, but achievable**
- **PGI 216.403-1(3)(i)(A) recommends a target cost for which the probability of an underrun and overrun are considered equal and therefore, the risks and rewards are shared equally, hence the 50/50 share is the point of departure.**
  - **The analyst should let the facts of the procurement determine the target cost and sharelines**

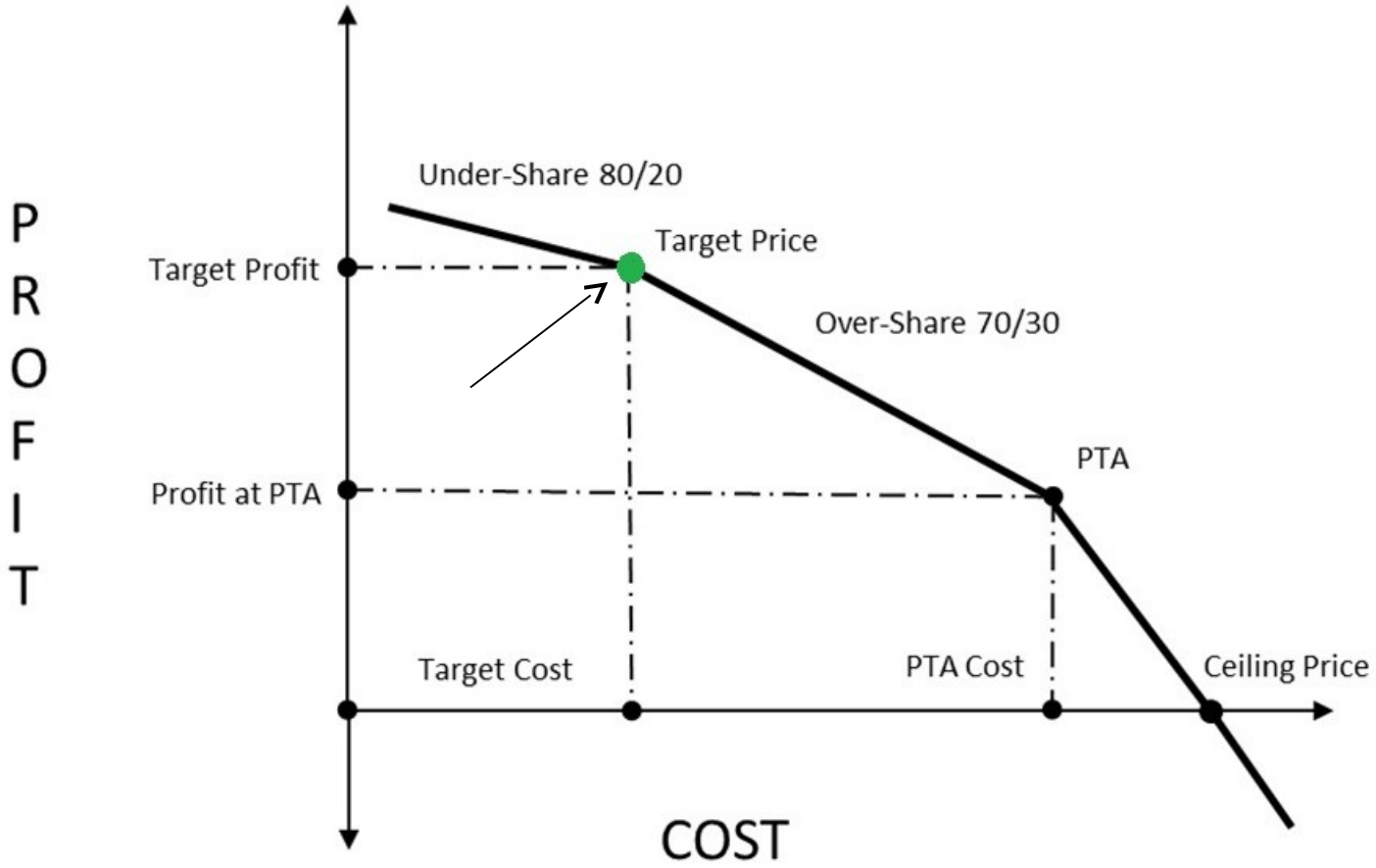
FPIF – Target Profit

- **The Target Profit dollars should come from the Weighted Guidelines method**



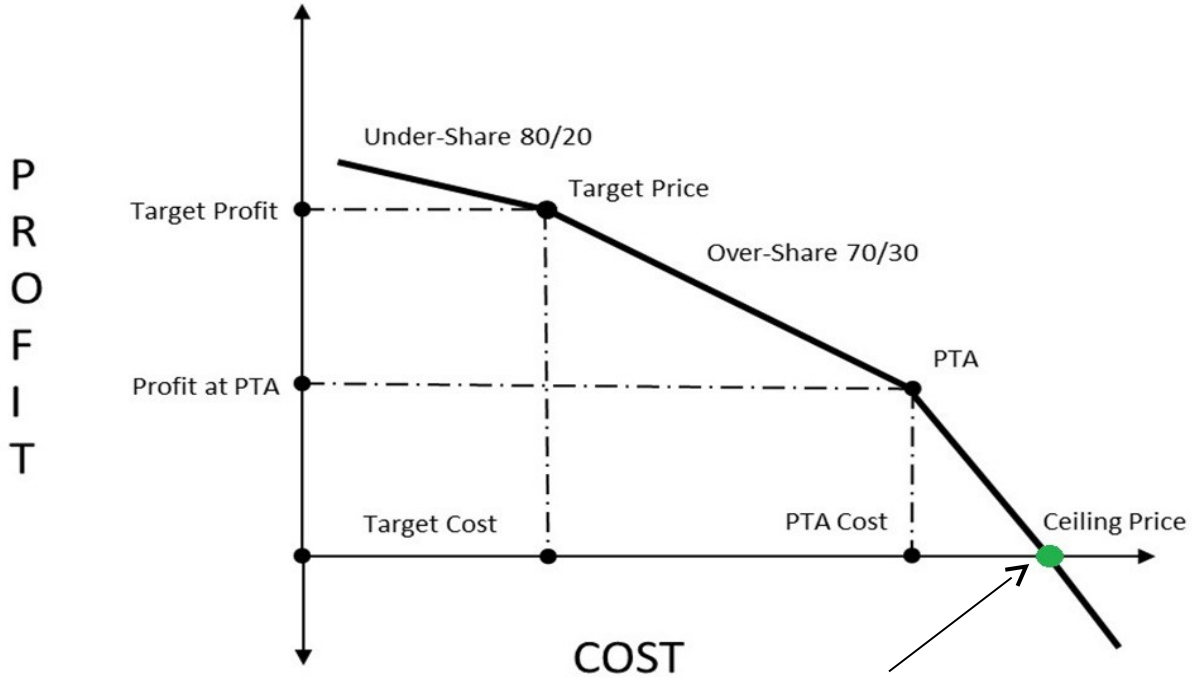
FPIF – Target Price

- **Target Cost + Target Profit = Target**



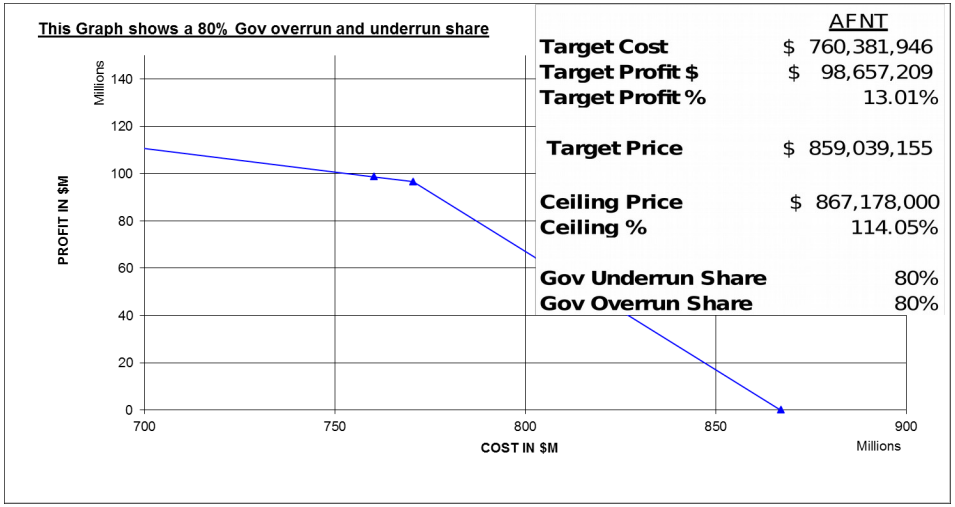
FPIF – Ceiling Price

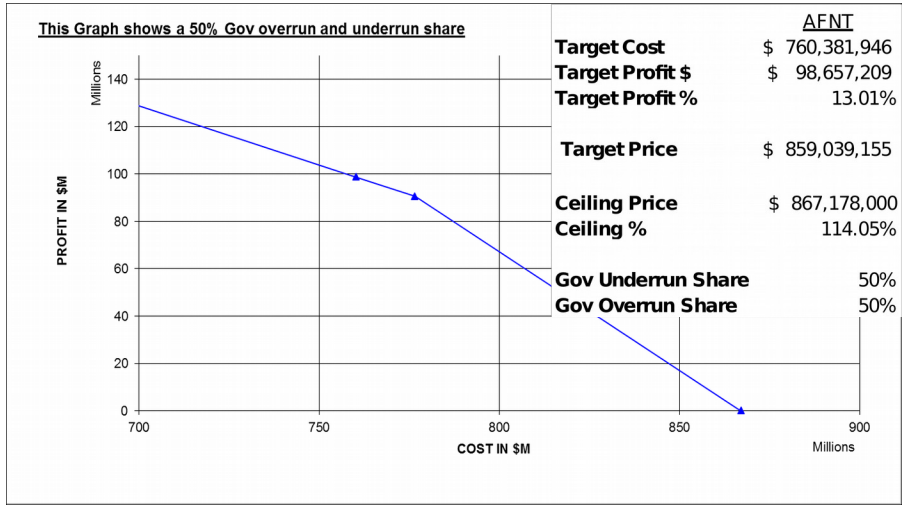
- Highest dollar amount the USG would have to pay under the contract geometry
- Expressed as a percent of target cost including cost of money
  - Ceiling increases as risk increases
  - PGI establishes 120% as point of departure
    - Mature production programs usually have a lower ceiling percentage than the 120% PGI



FPIF – Share Ratios

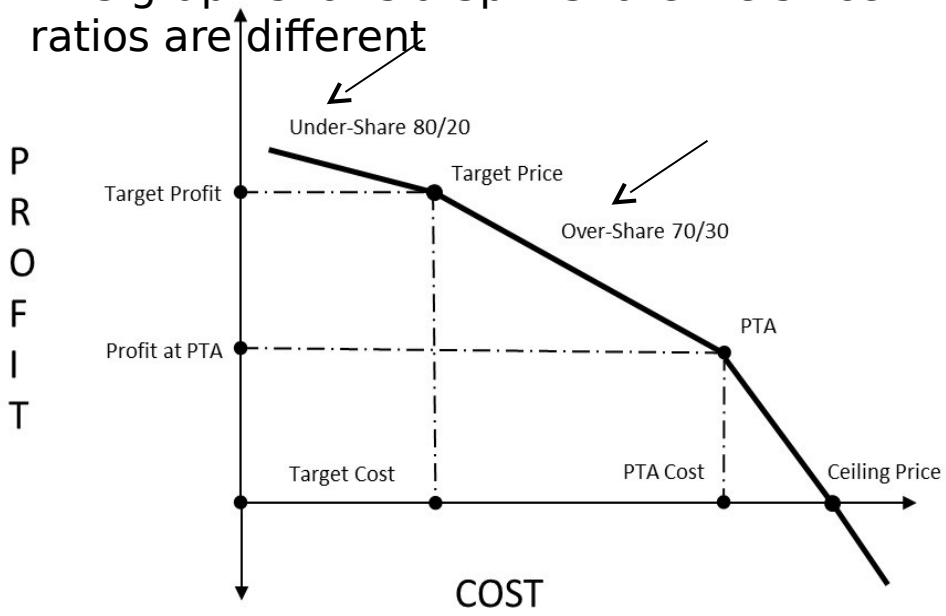
- **The Share Ratios dictate how much each party will share in the overruns and underruns**
- **The convention is to show the government % first**
  - **A 70/30 share ratio means the government share is 70%**
- **PGI 216.403-1(b)(2) establishes 50/50 as a point of departure**
  - **PGI NOTE: 50/50 creates an unsplit share ratio since both the underrun and overrun share ratios are the same**
- **Share ratios create the slope of the FPIF line up to the PTA**
  - **The lower the government share the steeper the line will be**





FPIF – Share Ratios

- Overrun share ratio determines how steep the line is between the Target Price and the Point of Total Assumption
  - As the overrun share becomes flatter (e.g. from 50/50 to 80/20), the government absorbs more of the overrun dollars and the contractor has less of a profit reduction as a result of the overrun
- Underrun share ratio determines how steep the line is below the Target Price
  - As the underrun share becomes flatter (e.g. from 50/50 to 80/20), the government benefits from more of the underrun and the contractor receives less of a profit increase as a result of the underrun
- This graph shows a Split Shareline since the overrun and underrun share ratios are different



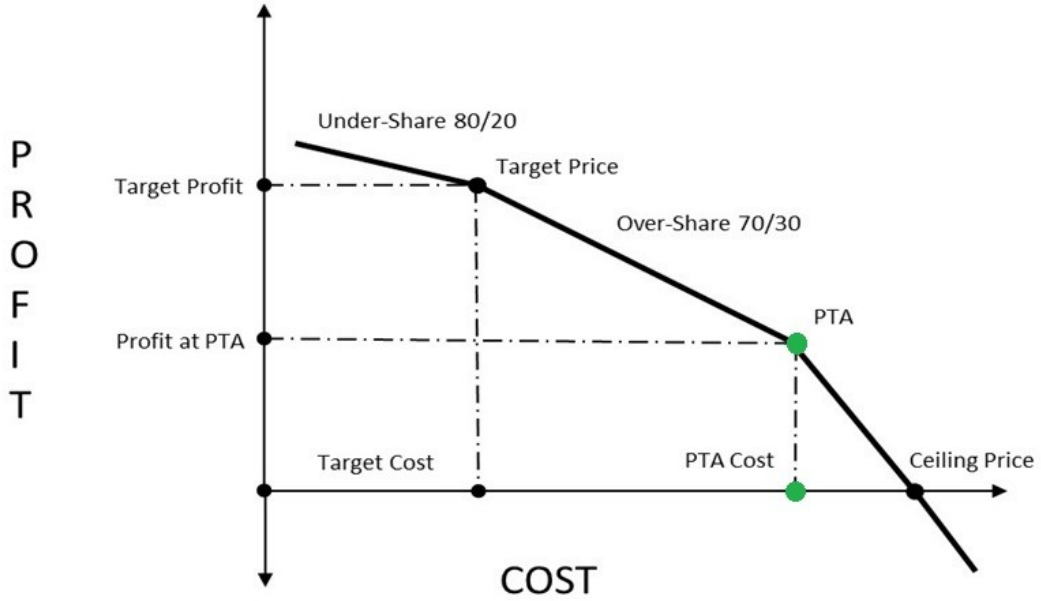
FPIF – Share Ratios

- **Contractor's Overrun Sha** $\frac{\text{Target Profit - Profit @ MPC}}{\text{Target Cost - MPC}}$
  - Multiply by negative 1 to get the positive value
  - MPC = Most Pessimistic Cost
  - Gov Share = 1- Contractor's Share
- **Contractor's Underrun Sha** $\frac{\text{Target Profit - Profit @ MOC}}{\text{Target Cost - MOC}}$
  - Multiply by negative 1 to get the positive value
  - MOC = Most Optimistic Cost
  - Gov Share = 1- Contractor's Share

Point of Total Assumption

- Point where contractor's cost share becomes equal to 0/100, like an FFP contract
  - USG will no longer share in any additional overrun
- Contractor assumes full responsibility for expending cost dollars when actual costs exceed PTA cost

$$\text{PTA COST} = \left[\frac{\text{Ceiling Price - Target Price}}{\text{Gov't Share}}\right] + \text{Target Cost}$$



Steps for Calculating FPIF Final Price

- **Step 1: Determine the contract final costs**
  - Contractor submits final cost proposal
  - Obtain Audit assistance
  - Determination of final allowable costs
- **Step 2: Calculate the Cost Underrun or (Overrun)**

  Underrun (Overrun) = Target Cost – Final Cost

  Note: Overruns are negative amounts

Steps for Calculating FPIF Final Price

- **Step 3: Calculate the Contractor Share of the Underrun or (Overrun)**

  Krt's Share (Profit Adjustment) = Ktr's Share Ratio x Underrun (Overrun)

  Notes:
  The Contractor's share of the underrun (overrun) is added to the target profit (profit adjustment)
  If there is an overrun, the profit adjustment will be a negative amount

Steps for Calculating FPIF Final Price

- **Step 4: Adjust Contractor Profit**

  Final Profit = Target profit + Profit Adjustment

- **Step 5: Determine Adjusted Contract Price**

  Adjusted Price = Final Cost + Final Profit

Steps for Calculating FPIF Final Price

- **Step 6: Compare Adjusted Price to Contract Ceiling**
  Rule: If Adjusted Price > Contract Ceiling, revert to contract ceiling

- **Step 7: Establish Final Contract Price**

Example

- Target Cost = $9,400,000
- Target Profit = $1,045,000
- Ceiling Price is $11,280,000 (120%)
- Share Ratio = 70/30

Calculate Final Contract Price

- Actual Cost = $ 8,700,000
- Actual Cost = $11,100,000

Example

- $9,400,000(TC) - $ 8,700,000(AC) = $700,000
- $700,000 * 30%(Ktr Share) = $210,000
- $1,045,000(TP) + $210,000 = $1,255,000
- $8,700,000(AC) + $1,255,000 = $9,955,000

- TC = Target Cost
- AC = Actual Cost
- TP Target Profit

Example

- $9,400,000(TC) - $ 11,100,000(AC) = -$1,700,000
- -$1,700,000 * 30%(Ktr Share) = -$510,000
- $1,045,000(TP) - $510,000 = $535,000
- $11,100,000(AC) + $535,000 = $11,635,000
  - BUT WAIT! That's higher than the ceiling, so we will go with the ceiling amount

- TC = Target Cost
- AC = Actual Cost
- TP Target Profit

Section 2

How to build an FPIF position using the Bottoms-Up Approach

FPIF Geometry Bottoms-Up Approach

- **Alternative to randomly choosing a ceiling % that may not reflect the true cost risk**
  - Avoids blunders like PTA exceeding ceiling
  - Provides a thoughtful process to deviate from the 50/50 share ratios with 120% ceiling in the PGI
- **Requires an assessment of most pessimistic cost (PTA) and associated reasonable profit rate**
  - Ceiling dollar amount, ceiling %, and overrun share % are determined by the PTA and profit at PTA positions
  - Enables negotiation based on merits of the analysis as opposed to randomly negotiating the ceiling percentage
  - Example – PCO can discuss why a 120% ceiling is

FPIF Geometry Bottoms-Up Approach

1. Develop most pessimistic cost position by cost element (PTA Cost)
2. Determine reasonable profit rate at PTA cost
3. Add PTA cost and PTA profit to get ceiling
4. Derive the Share Ratios

FPIF Bottoms Up Approach – Develop PTA Cost

- **PTA Cost represents the most pessimistic cost position**
  - **Most pessimistic cost position for each cost element should be a position that could happen although it is unlikely that it would happen**
  - **Most pessimistic position is built from:**
    - Technical Evaluation maximum position
    - DCMA FPRR/FPRA/FPRP
    - Program Office/Pricer Analysis

FPIF Bottoms Up Approach – Develop PTA Cost

- **Material/Subcontracts**
  - **Negotiated FFP vendors generally pose little risk to the prime**
  - **Risk issues:**
    - Late delivery – what does history show?
    - Quality issues – what does history show, hold vendor responsible
    - Vendor default – highly unlikely
- **Indirect Rates**
  - **Risk issue: will actual rates exceed negotiated rates**
  - **What does history show**
    - Look at history of forecasted rates 2-3 years out

FPIF Bottoms Up Approach – Develop PTA Cost

- **Labor Hours**
  - **Risk issue: tasks will take more hours than negotiated**
    - What does history show – how challenging is the target cost
- **Labor Rates**
  - **Risk issue: actual rates paid to employees will exceed negotiated rates – generally low risk**
- **Schedule Risk**
  - **Schedule slip can only affect prime contractor's internal cost**
  - **Impact of a schedule slip will not be prime headcount (standing army) X months slip**
    - Contractor will not have people sitting around
- **PTA Cost represents most pessimistic cost**

FPIF Bottoms Up Approach – Determine Profit at PTA

- **Determine a reasonable profit rate at the PTA Cost**
- **The PTA profit rate is a judgment call on how much profit the Contractor should earn when they overrun to the most pessimistic cost**
  - Need to have a discussion with the Program Manager about what profit rate should be applied to the most pessimistic cost

FPIF Bottoms Up Approach – Determine Ceiling Price

- **PTA cost + PTA profit = Ceiling**

FPIF Bottoms Up Approach – Derive Share Ratios

- **Contractor's Overrun share equals** $\frac{\text{Target Profit - Profit at PTA}}{\text{Target Cost - PTA Cost}}$
  - **When building the FPIF geometry using the Bottoms Up Approach, the overrun share ratio will be calculated once the target cost, target profit, PTA cost (most pessimistic cost), and profit at PTA are determined**
- **Underrun share ratio will be determined by PCO judgment**
  - **Traditional approach in AFMC has been to use the same ratio as the overrun**
    - Creates an unsplit shareline
  - **If you sustain a reasonably challenging but achievable cost position in negotiations, it may be appropriate to use 20/80 for the underrun**
    - This makes sense on production efforts where previous efforts have been FFP and contractor benefited from entire cost underrun
  - **As you make judgmental concessions during negotiations, it may be appropriate to increase the government's underrun share**

Section 3

How to use the AFMC model to build an FPIF position

AFMC FPIF Model – Step 1

- **Input the target cost (or objective position) for each cost element as show below. These numbers will come from the Tech Eval, the DCAA Audit Report, DCMA FPRAs/FPRRS, PK judgment, or other similar artifacts.**

Cost Element	Target Cost
Material/Interdivisional Transfer	$ 300,000,000
Material Overhead	$ 10,000,000
Engineering	$ 15,000,000
Engineering Overhead	$ 40,000,000
Manufacturing	$ 25,000,000
Manufacturing Overhead	$ 30,000,000
Other Labor	$ 10,000,000
Other Labor Overhead	$ 30,000,000
Other Costs	$ 5,000,000
G & A Expense	$ 50,000,000
Cost of Money	$ 1,000,000
Total Cost:	$ 516,000,000
	Target Cost

AFMC FPIF Model – Step 2

- **Input the target profit rate. This rate should come from the DD 1547 Weighted Guidelines**

Profit Rate:	Profit Rate
	11.00%

- **The model automatically generates target price.**

Target Price
$572,650,000

AFMC FPIF Model – Step 3

- **Input the most likely pessimistic position factors for each cost element to derive the most pessimistic cost position**

Overrun Factors	Most Pessimistic Cost/ Point of Total Assumption (PTA)
103.33%	$ 310,000,000
100.00%	$ 10,000,000
113.33%	$ 17,000,000
117.50%	$ 47,000,000
108.00%	$ 27,000,000
112.67%	$ 33,800,000
270.00%	$ 27,000,000
111.00%	$ 33,300,000
115.00%	$ 5,750,000
120.00%	$ 60,000,000
120.00%	$ 1,200,000

AFMC FPIF Model – Step 4

- **Input the profit rate at the PTA/Pessimistic cost. This is a judgment call. How much profit should the contractor earn when they overrun to the Most Pessimistic Cost position? Discuss with Program Management.**

Profit Rate
6.00%

- **Completion of this step will automatically generate both the ceiling amount and the ceiling percentage**

Ceiling Amount and %
$ 606,290,930
117.50%

AFMC FPIF Model – Step 5

- **Input the Government Underrun Share Ratio. This is a judgment call.**
  - **NOTE: the overrun share ratio will be determined once the target cost, target profit, PTA cost (most pessimistic cost), and profit at PTA are determined**

Share Ratio:	Enter Gov Underrun Share
	Gov Share
Underrun	20.00%

- **Completion of this step will automatically generate the Government's and the Contractor's overrun and underrun share**

	Gov	KTR
Underrun	20.00%	80.00%
Overrun	60.04%	39.96%

FPIF

- The model will automatically create a graph of the inputs

Section 4

Negotiation Tips

FPIF – Negotiations Contract Geometry is the deal

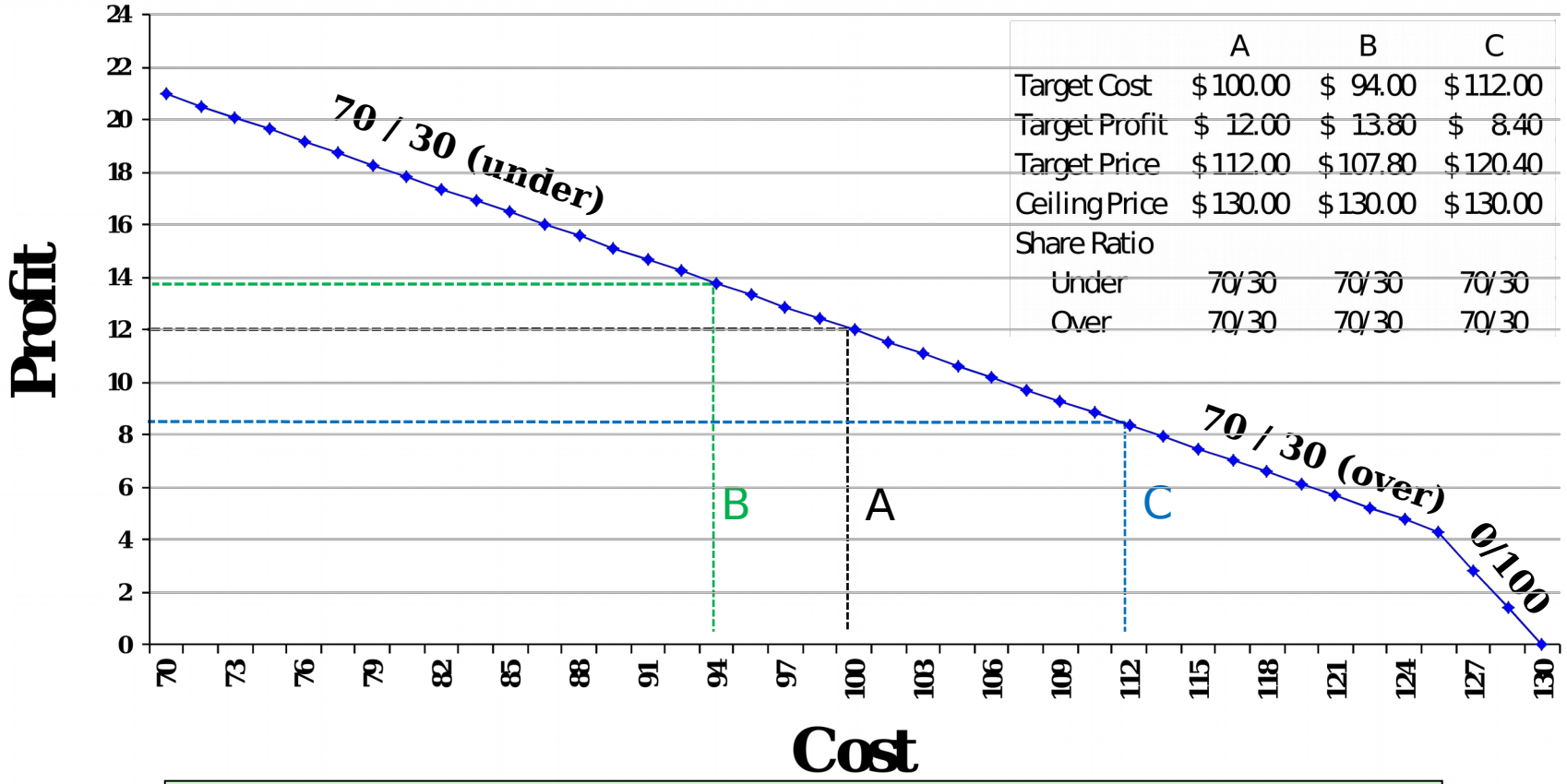
- **Do not negotiate any single point/FPIF element without negotiating all of the elements**
  - **E.g. don't settle on an overrun share when you are still negotiating the target cost, target profit, and ceiling**
- **The contract geometry is the deal**

FPIF – Negotiations Contract Geometry is the deal

- **Contractor offers you three settlement options. Which should you choose?**

	A		B		C	
Target Cost	$100M		$94M		$112M	
Target Profit	$12M	12%	$13.8M	14.70%	$8.4M	7.50%
Target Price	$112M		$107.8M		$120.4M	
Ceiling Price	$130M	130%	$130M	138%	$130M	116%
Share Ratio						
Under	70/30		70/30		70/30	
Over	70/30		70/30		70/30	

FPIF – Negotiations Contract Geometry is the deal



	A	B	C
Target Cost	$100.00	$ 94.00	$112.00
Target Profit	$ 12.00	$ 13.80	$ 8.40
Target Price	$112.00	$107.80	$120.40
Ceiling Price	$130.00	$130.00	$130.00
Share Ratio			
Under	70/30	70/30	70/30
Over	70/30	70/30	70/30

All three offers fall on the same FPIF line, therefore they are all the same offer.

The final price to the Government under all three scenarios will be the same at every possible cost outcome.

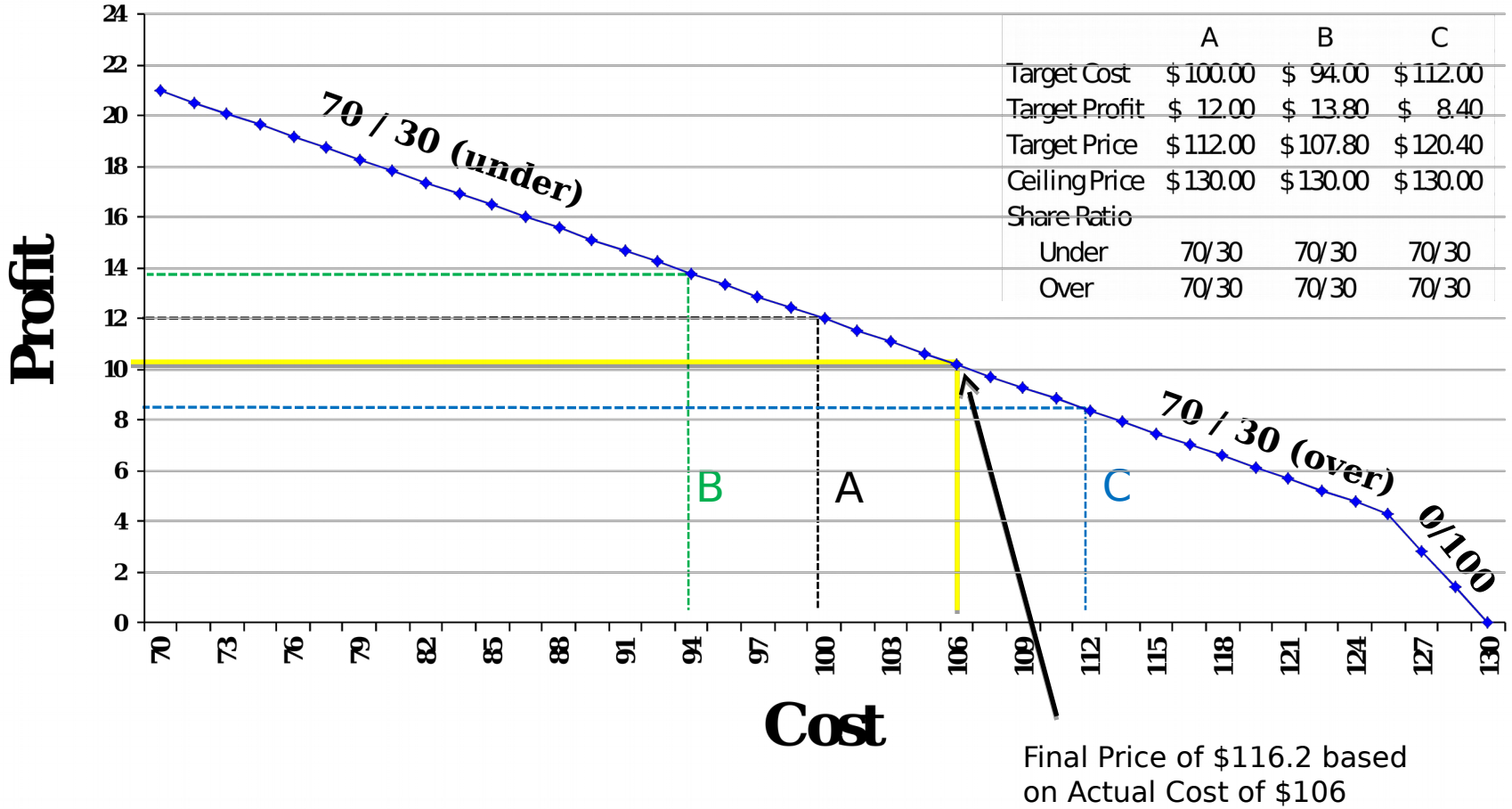
FPIF – Negotiations Contract Geometry is the deal

- **Under each of the three scenarios on the previous chart what would the price be if the actual cost was $106?**

Scenario A	Scenario B	Scenario C
$100[TC] - $106[AC] = -$6 -$6*.30[K's OS] = -$1.8 $12[TP] + -$1.8 = $10.2 $106 + $10.2 = $116.2	$94[TC] - $106[AC] = -$12 -$12*.30[K's OS] = -$3.6 $13.8[TP] + -$3.6 = $10.2 $106 + $10.2 = $116.2	$112[TC] - $106[AC] = $6 $6*.30[K's US] = $1.8 $8.4[TP] + $1.8 = $10.2 $106 + $10.2 = $116.2

- TC = Target Cost
- AC = Actual Cost
- TP = Target Profit
- OS = Overrun Share
- US = Underrun Share

FPIF – Negotiations Contract Geometry is the deal



	A	B	C
Target Cost	$ 100.00	$ 94.00	$ 112.00
Target Profit	$ 12.00	$ 13.80	$ 8.40
Target Price	$ 112.00	$ 107.80	$ 120.40
Ceiling Price	$ 130.00	$ 130.00	$ 130.00
Share Ratio			
Under	70/30	70/30	70/30
Over	70/30	70/30	70/30

The Arrow represents the Actual Cost and the corresponding Profit

This illustrates how any actual costs that fall on the line will yield the same actual price

FPIF – Negotiations Contract Geometry is the deal

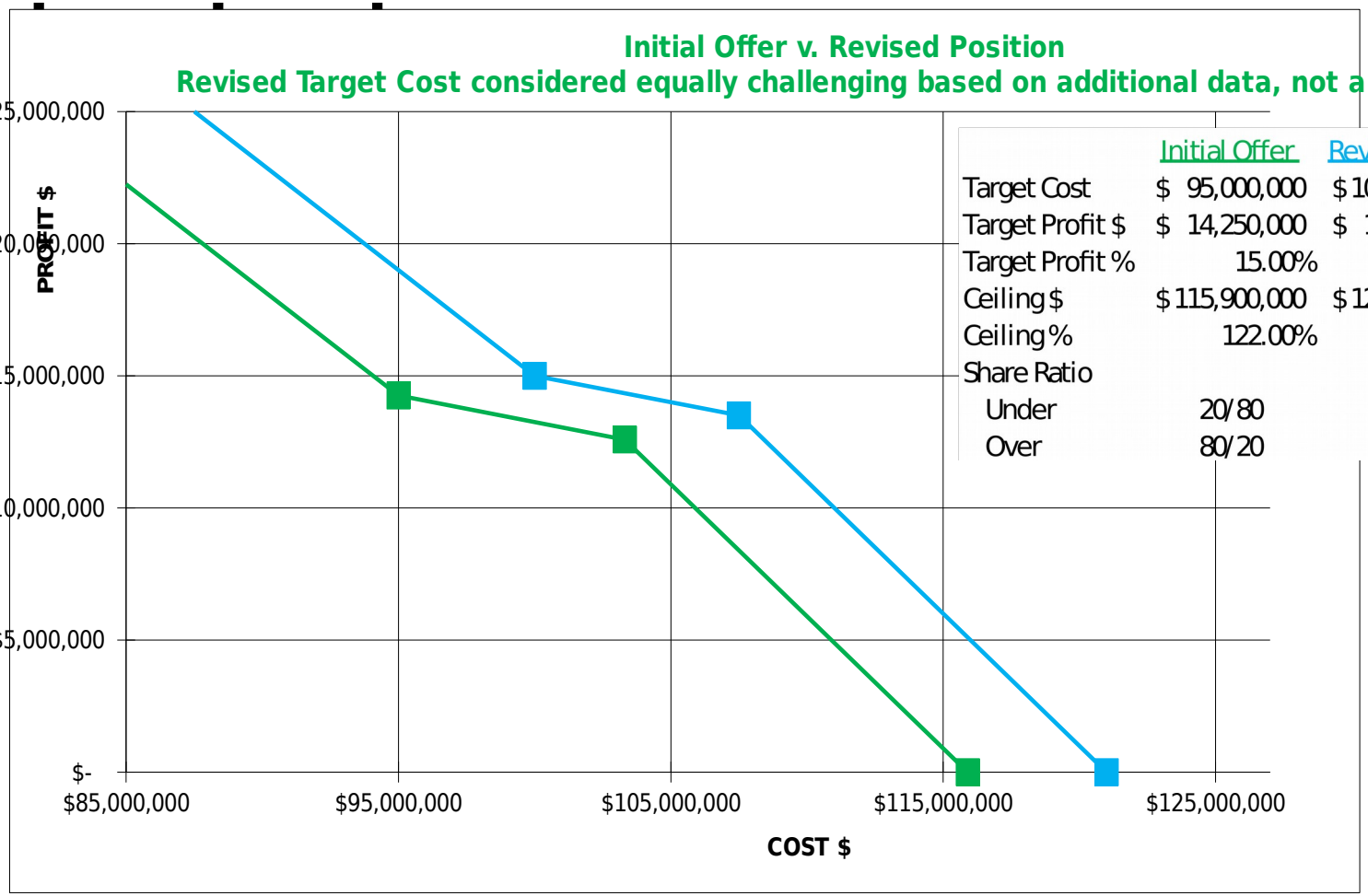
- **Any point along a constant *unsplit* share line (same share over and under) represents the same deal so long as the:**
  - **Ceiling Price dollars are held constant**
- **Once one determines the geometry of the FPIF line to be fair and reasonable, then all points along that line are fair and reasonable**
  - **This can be helpful in closing the deal**
    - Contractor wants a higher target cost on contract – if you move to their point on the line (adjusting profit downward) and maintaining your ceiling dollars (adjusting ceiling rate), you will end up with the same

FPIF – Negotiations Contractor Provides Reasonable Justification

- **If the contractor provides justification that the Government team verifies, it is reasonable to shift the FPIF line accordingly**
  - **Target cost would increase by amount justified by contractor data**
  - **Target profit percentage would remain the same**
  - **Ceiling dollars would increase**
  - **Ceiling percentage could increase or decrease as determined by reasonable judgment**
  - **Share ratios would remain the same**

FPIF – Negotiations Contractor Provides Reasonable Justification

- **Contractor provides justification to move**

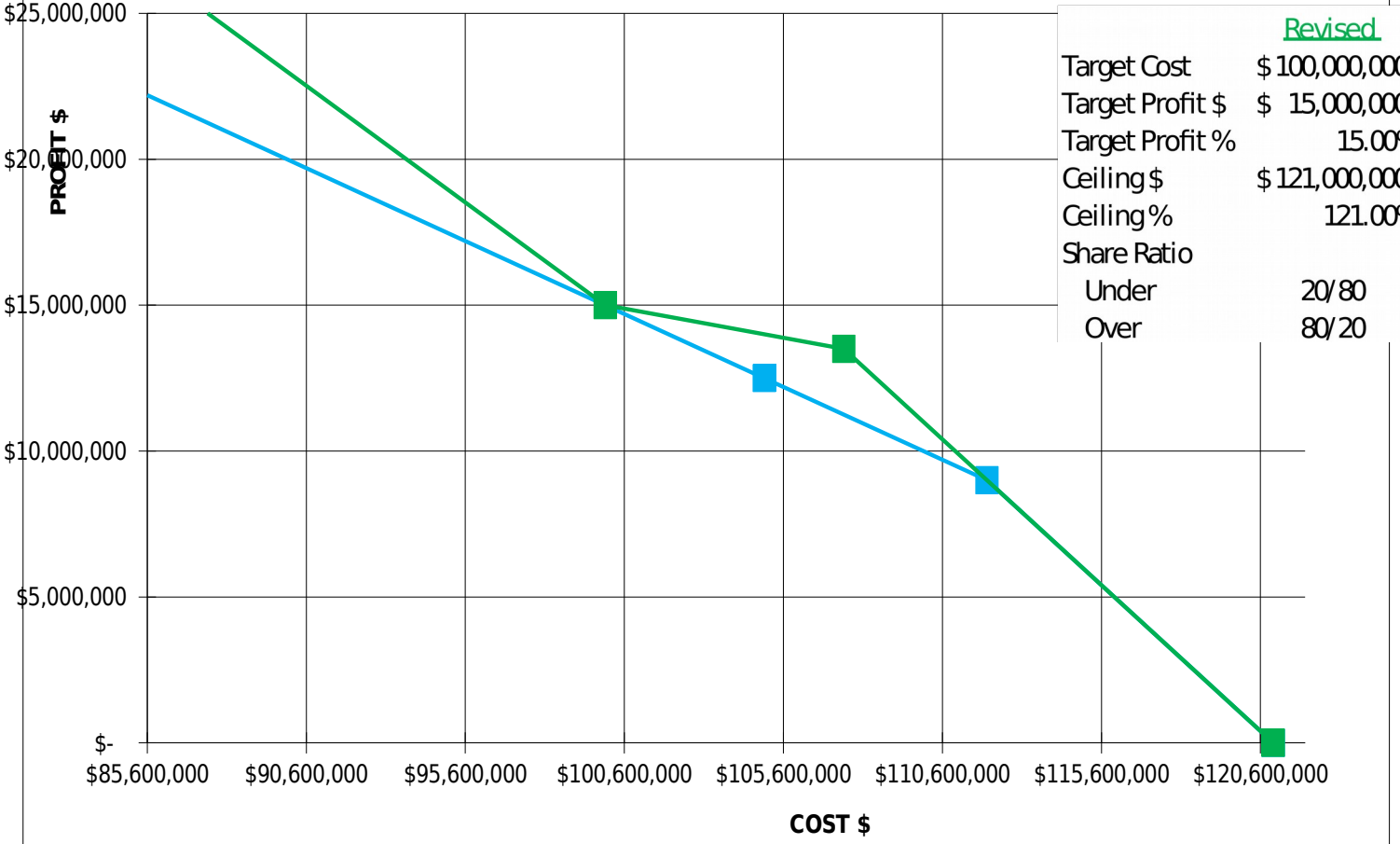


FPIF – Negotiations
Contractor Does not Provide Reasonable Justification

- **If the contractor cannot provide reasonable justification to support the contractor cost line, the Government team can move to the contractor's target cost BUT**
  - **Target cost would increase**
  - **Target profit percentage would decrease**
  - **Ceiling dollars should remain the same**
  - **Ceiling percentage would decrease**
  - **Government underrun share ratio would increase**
  - **Government overrun share ratio would decrease**

FPIF – Negotiations
Contractor Does not Provide Reasonable Justification

- **Government makes a Negotiation Concession**

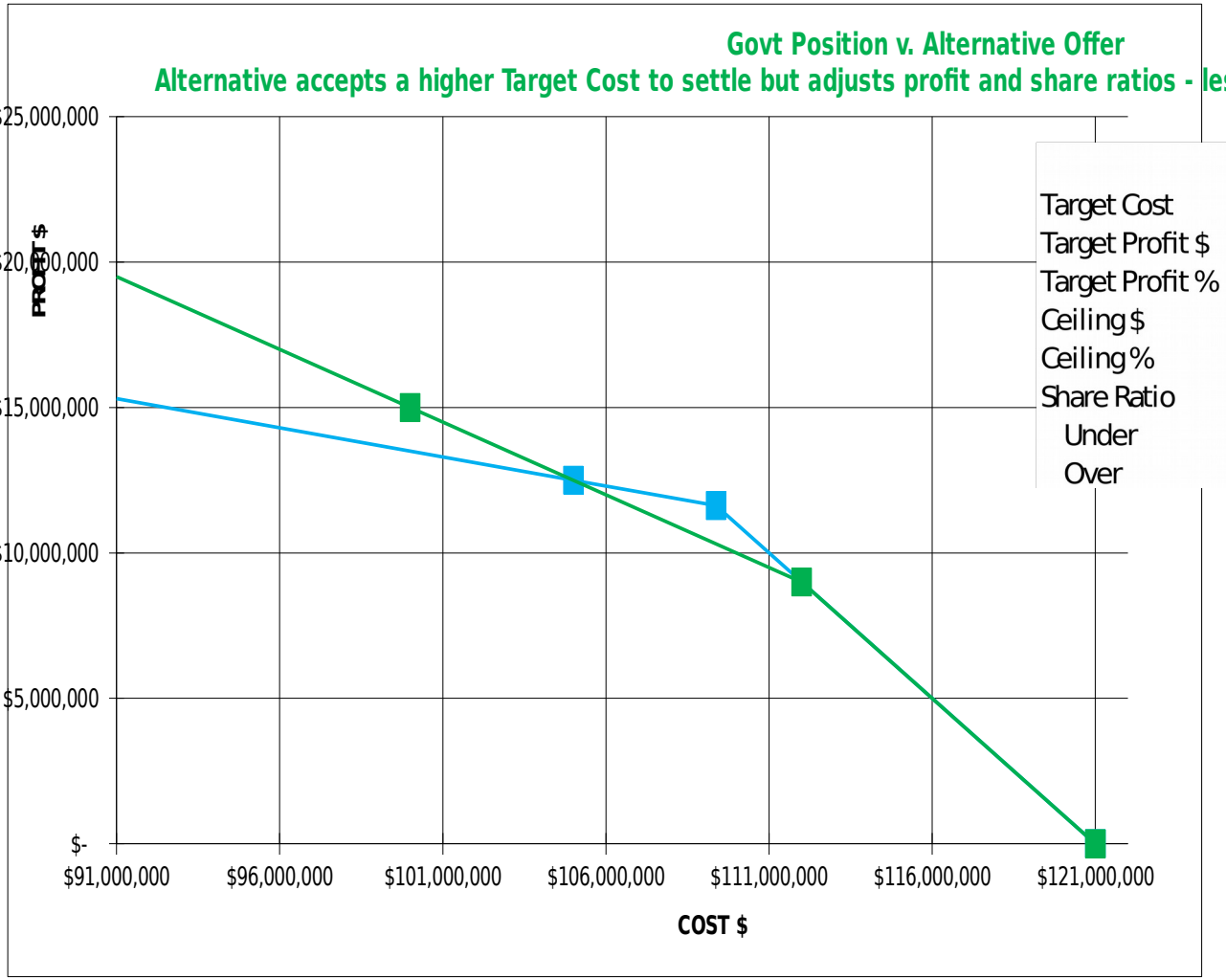


	Revised	Concession
Target Cost	$ 100,000,000	$ 105,000,000
Target Profit $	$ 15,000,000	$ 12,500,014
Target Profit %	15.00%	11.90%
Ceiling $	$ 121,000,000	$ 121,000,000
Ceiling %	121.00%	115.24%
Share Ratio		
Under	20/80	50/50
Over	80/20	50/50

- **If the Government expects contractor to underrun their current cost position the Government can offer an alternative offer at the contractor's cost with less profit and a flatter share ratio**
  - **This would provide more profit than the Government position on the overrun side but less profit on the underrun side**

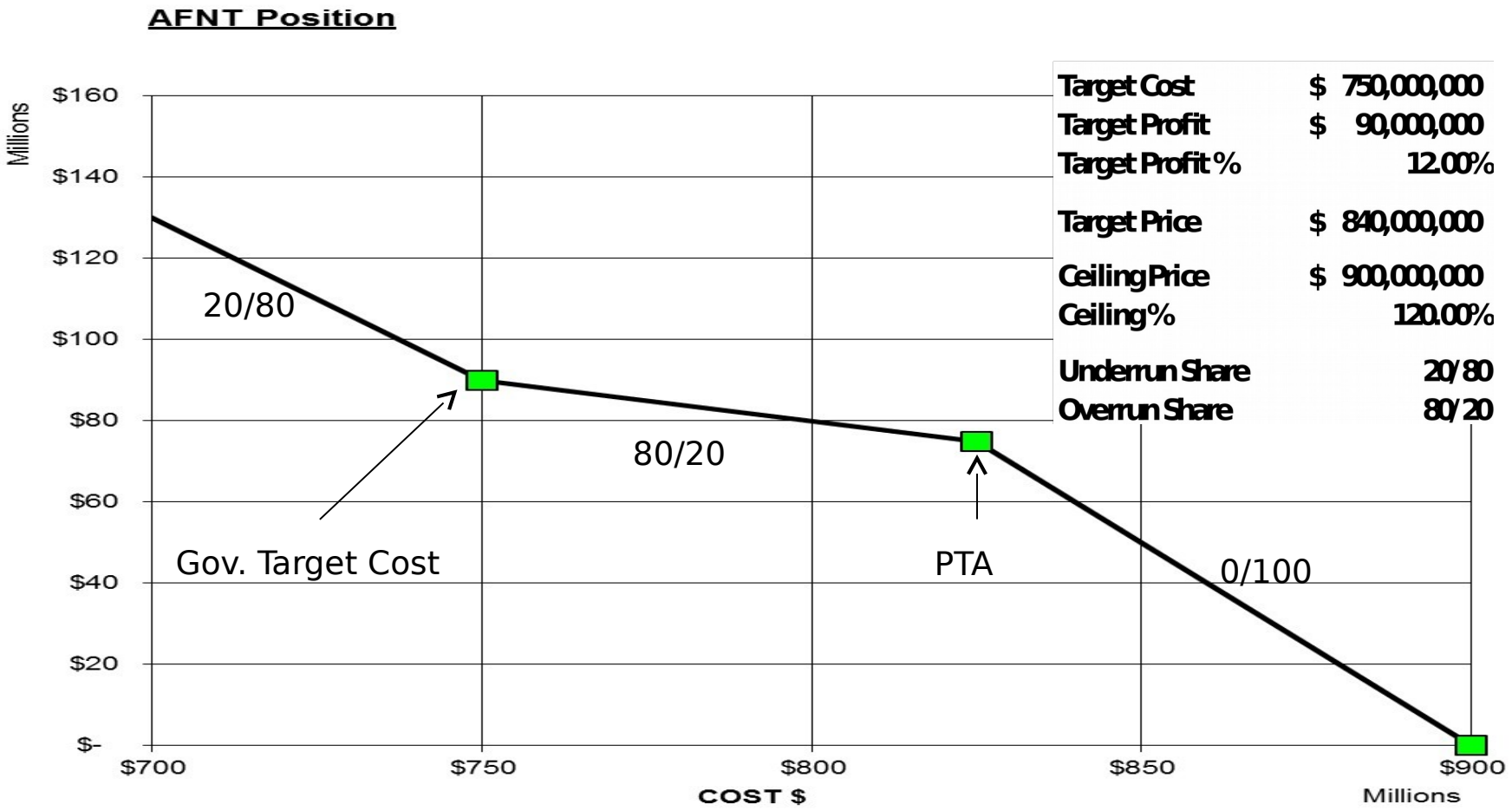
FPIF – Negotiations Alternative Offer

- **Government makes an Alternative Offer**



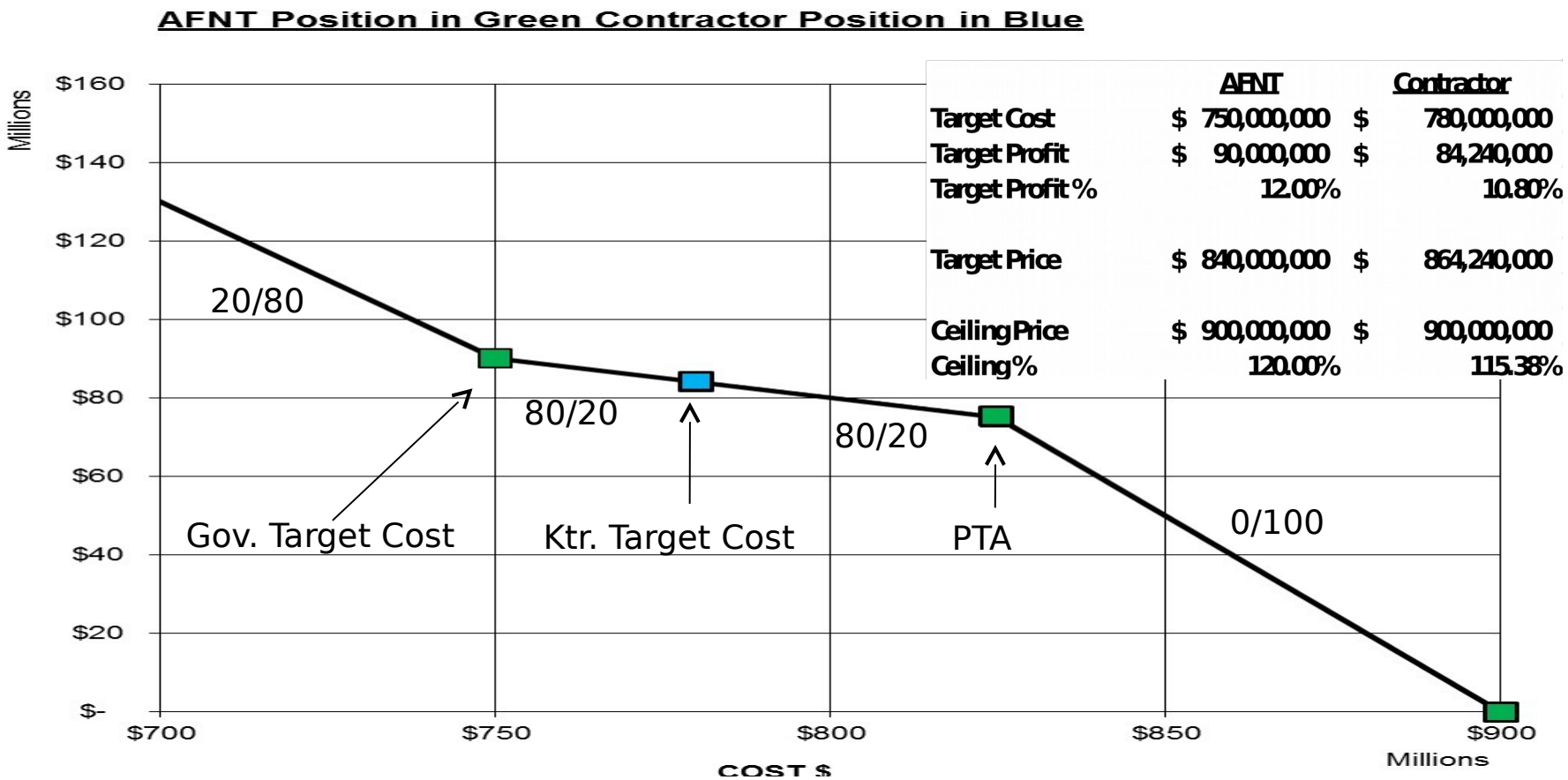
	Gov Position	Alternative
Target Cost	$ 100,000,000	$ 105,000,000
Target Profit $	$ 15,000,000	$ 12,499,986
Target Profit %	15.00%	11.90%
Ceiling $	$ 121,000,000	$ 121,000,000
Ceiling %	121.00%	115.24%
Share Ratio		
Under	50/50	50/50
Over	50/50	80/20

FPIF – Negotiations Split Shares



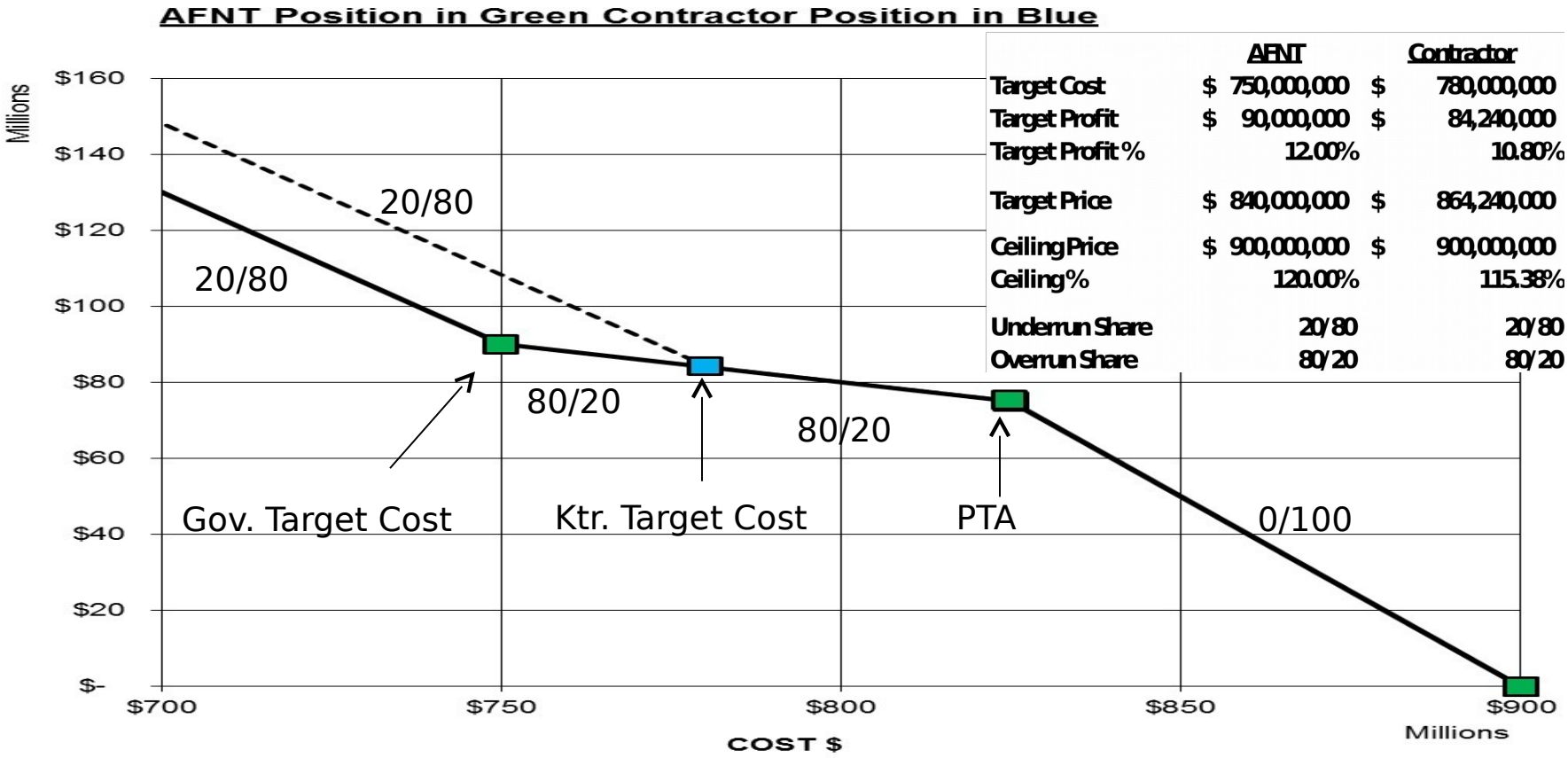
- It is late in negotiations and a deal is imminent
- The graph above shows the AFNT settlement position, which includes different underrun/overrun share ratios

FPIF – Negotiations Split Shares



- Contractor's target cost, target profit, overrun shares (80/20), and ceiling all fall on the AFNT's FPIF line
- Contractor also willing to accept government underrun share – how will that impact the deal and is that a good idea?

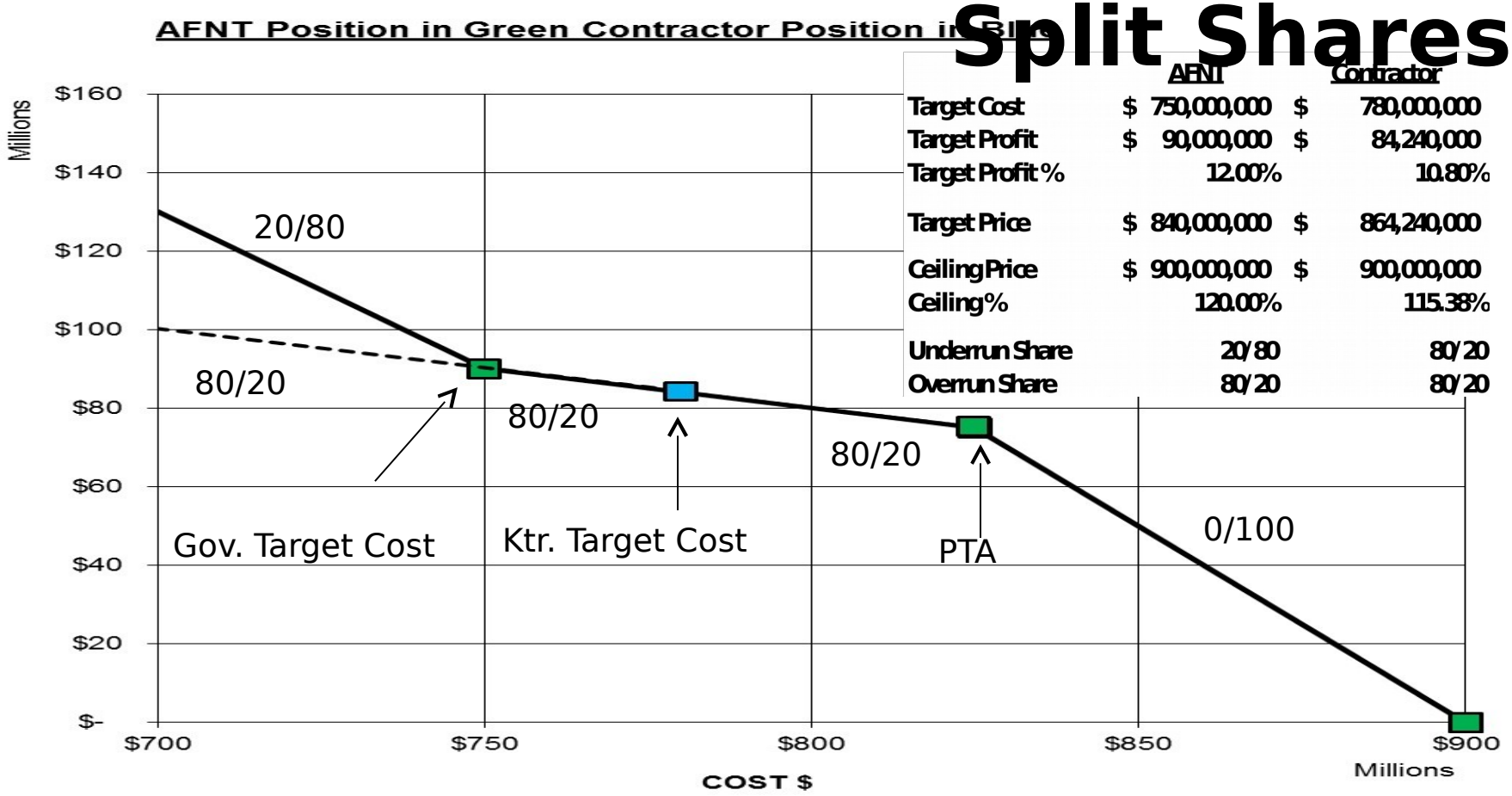
FPIF – Negotiations Split Shares



	AFNT	Contractor
Target Cost	$ 750,000,000	$ 780,000,000
Target Profit	$ 90,000,000	$ 84,240,000
Target Profit %	12.00%	10.80%
Target Price	$ 840,000,000	$ 864,240,000
Ceiling Price	$ 900,000,000	$ 900,000,000
Ceiling %	120.00%	115.38%
Underrun Share	20/80	20/80
Overrun Share	80/20	80/20

- The dotted line shows the impact to the AFNT settlement position
- Should the AFNT maintain the 20/80 underrun share?
- How can we salvage our deal?

FPIF – Negotiations Split Shares



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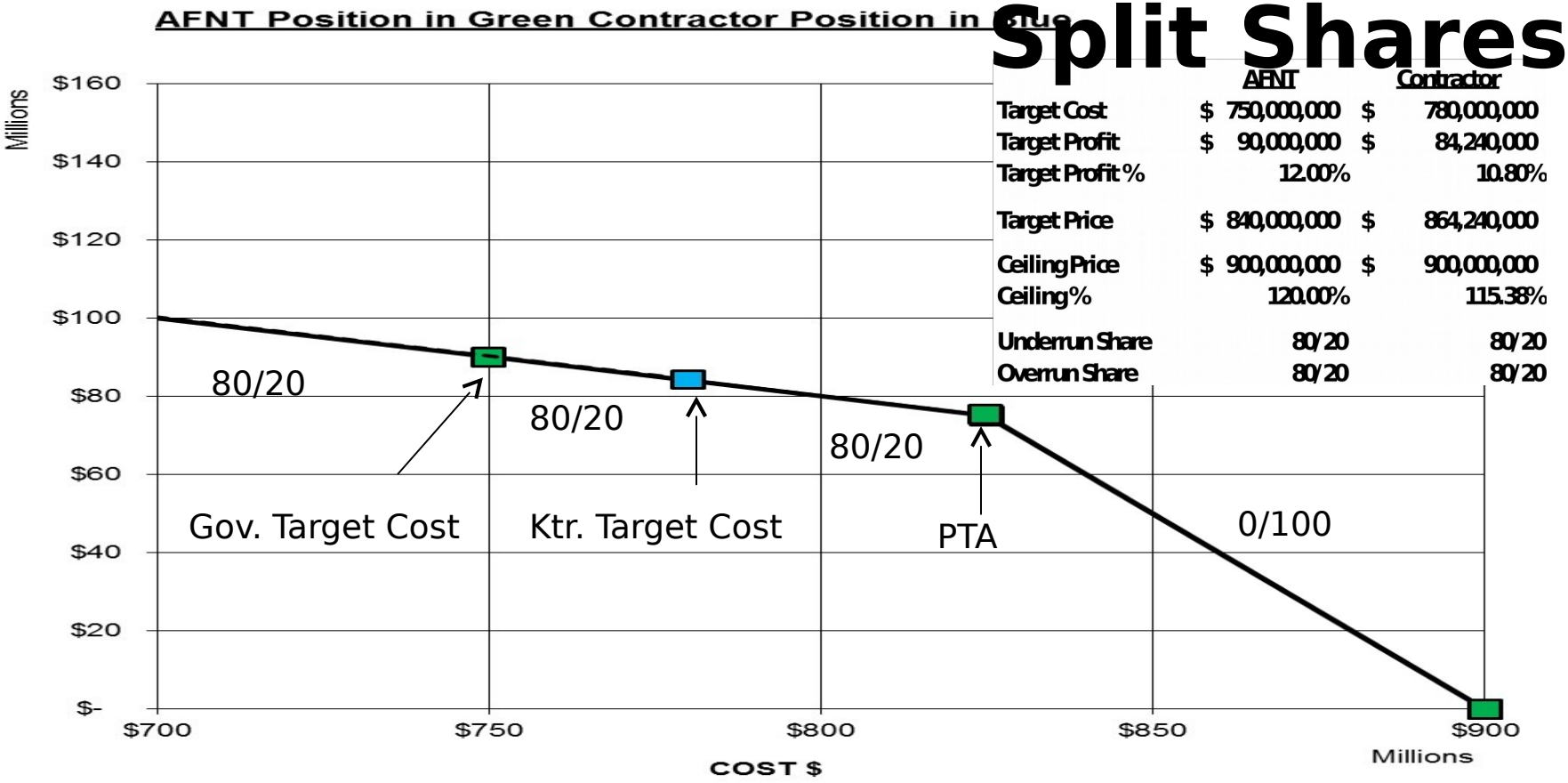
Target Price	$ 840,000,000	$ 864,240,000
Ceiling Price	$ 900,000,000	$ 900,000,000
Ceiling %	120.00%	115.38%
Underrun Share	20/80	80/20
Overrun Share	80/20	80/20

- If we change the underrun share from 20/80 to 80/20 up to the Contractor's cost, we get the same FPIF line from the AFNT target cost to the ceiling
- Overall, how does this impact the AFNT settlement position? (Reference dotted line)
- Can we put this on contract and write to it in the PNM?

FPIF – Negotiations Split Shares



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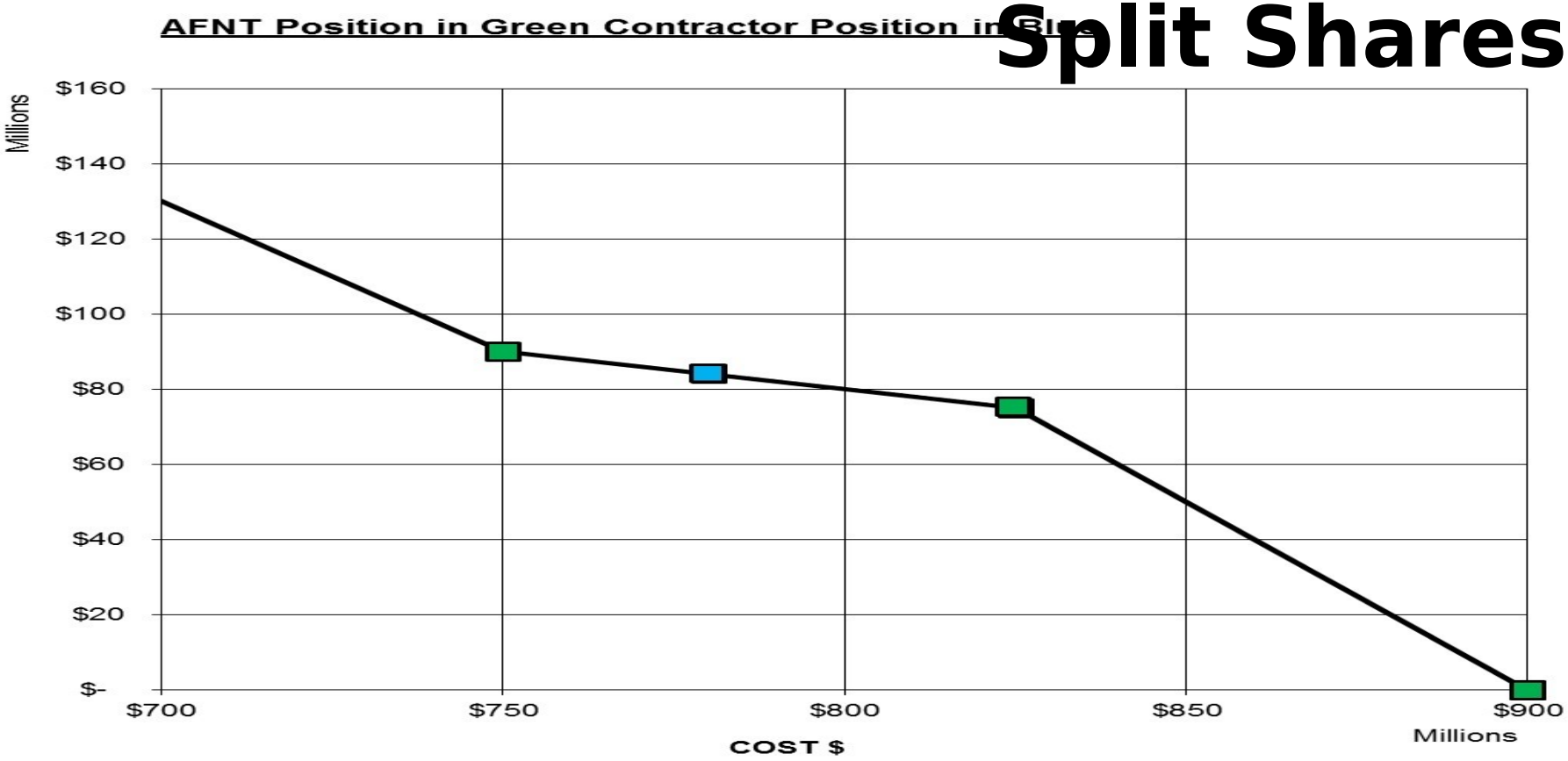
Target Profit	$ 90,000,000	$ 84,240,000
Target Profit %	12.00%	10.80%
Target Price	$ 840,000,000	$ 864,240,000
Ceiling Price	$ 900,000,000	$ 900,000,000
Ceiling %	120.00%	115.38%
Underrun Share	80/20	80/20
Overrun Share	80/20	80/20

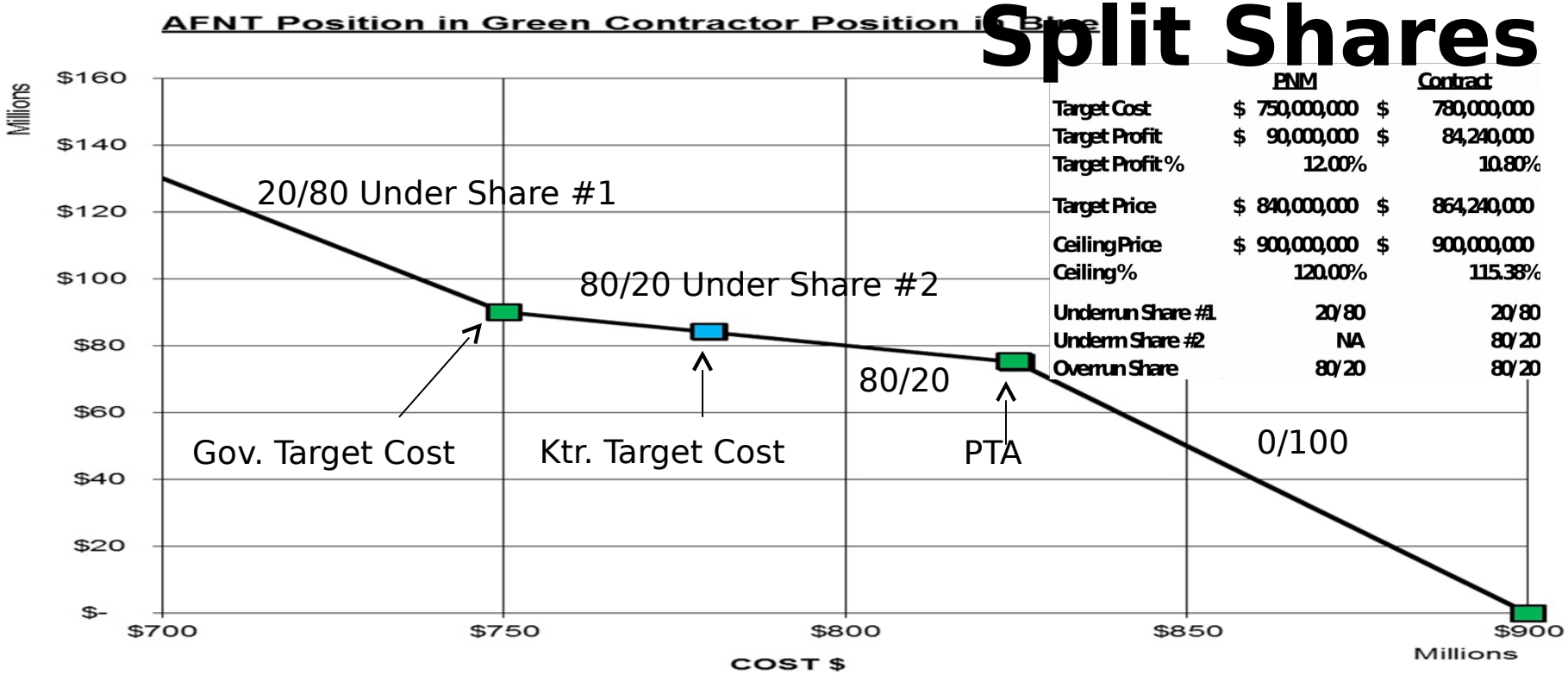
- Increasing the Gov underrun share from 20/80 to 80/20 is the optimal solution
  - If the contractor claims they need a higher cost line due to potential overrun, than the contractor should agree to a higher government underrun share
- The AFNT can put the Contractor's target cost/associated profit, ceiling (same as ours), and 80/20 underrun/overrun share ratios on contract while writing to the

FPIF – Negotiations Split Shares



- If the Contactor will not agree with increasing the Government underrun share since they would be pocketing less profit for underruns, what should we do?
- Ideally, we would get the Contractor to agree to revert to the original AFNT target cost/associated profit position to place on contract
- What if the contractor insists on putting the $780M on contract?

FPIF – Negotiations Split Shares



	PNM	Contract
Target Cost	$ 750,000,000	$ 780,000,000
Target Profit	$ 90,000,000	$ 84,240,000
Target Profit %	12.00%	10.80%
Target Price	$ 840,000,000	$ 864,240,000
Ceiling Price	$ 900,000,000	$ 900,000,000
Ceiling %	120.00%	115.38%
Underrun Share #1	20/80	20/80
Underrn Share #2	NA	80/20
Overrun Share	80/20	80/20

- Is it possible to put the Contractor's target cost position on contract and still have it follow the entire AFNT FPIF line?
- This requires two separate underrun share ratios (overrun is unchanged at 80/20)
  - The first underrun share ratio would be 20/80 for less than $750M
  - The second underrun share ratio would be 80/20 from $780M to $750M
  - In the PNM, the AFNT would still write to the original $750M target cost settlement position with associated profit (note ceiling still reflects original settlement position)

Section 5

Administrative Considerations (Pricing Perspective)

Administrative Considerations
(from a pricing perspective)

- **The following elements of the FPIF geometry will normally carry forward for the life of the contract**
  - **Underrun and Overrun share ratios**
  - **If you choose to establish more than one underrun or overrun share ratios, think through how modifications should be handled**
  - **If you establish a 20/80 underrun share ratio because you negotiated a challenging cost line, doesn't it follow that any future actions you negotiate should also include a challenging cost line?**
- **Target profit is a lump sum of dollars that go on contract**
  - **You do not have to use the same target profit rate in future modifications to an FPIF contract**
- **Ceiling is a lump sum of dollars that go on contract**
  - **You do not have to use the same ceiling rate in future modifications to an FPIF contract, if there is rationale to deviate from what you originally established**

Administrative Considerations
(from a pricing perspective)

- **If the contractor is underrunning and offers to convert to FFP, what are some factors you might consider?**
  - **Getting program money back sooner rather than later seems like a good idea**
  - **Avoiding the future burden of administering the FPIF seems like a good idea**
    - Consider whether the contractor wants to avoid an audit?
  - **Is Earned Value Management in place or was it waived?**
  - **Do you understand the Estimate At Completion (EAC) well enough to do a conversion that will accurately reflect what will happen on the contract?**
    - Danger is that EACs frequently reflect management reserve which contains considerable judgment
    - Experience in reviewing EACs for actuals in pre-award context indicates an inherent amount of pessimism for future costs which may be misplaced
    - If the EAC does not receive a thorough review, the government could overpay in the conversion
  - **It is generally assumed the contractor would not offer this early in the contract or that would be another reason for further investigation**

Administrative Considerations
(from a pricing perspective)

- **If the contractor is overrunning and offers to convert to an FFP, what are some factors you might consider?**
  - **If effort is in a late stage and it is clear the final price would exceed ceiling and therefore the contract will revert to ceiling, less risky to convert to FFP**
  - **Avoiding the future burden of administering the FPIF is a good sell**
    - Consider whether you want to recognize additional cost without an audit
  - **Is Earned Value Management in place or was it waived?**
  - **Do you understand the Estimate At Completion (EAC) well enough to do a conversion that will accurately reflect what will happen on the contract?**
    - Danger is that EACs frequently reflect management reserve which contains considerable judgment
    - Experience in reviewing EACs for actuals in pre-award context indicates an inherent amount of pessimism for future costs which may be misplaced
    - If the EAC does not receive a thorough review, the government could overpay in the conversion
  - **It is generally assumed the contractor would not offer this early in the contract or that would be another reason for further investigation**

Section 6

FPIF in a Competitive Environment

FPIF in a Competitive Environment

- **DOD Pricing preference is to evaluate offers at ceiling price as opposed to conducting a cost realism analysis against target cost**
  - **Greatly simplifies evaluation and avoids potential pitfalls associated with cost realism analysis**
  - **Establish target profit rate, ceiling rate, underrun and overrun share ratios up front (include in solicitation)**
- **Ceiling rate and share ratios require thought!**
  - **The idea of 20/80 underrun may not make sense in a competitive context**
    - For example, in a development scenario, we might want to establish an 80/20 underrun to encourage the contractor to spend the money
    - Ceiling rate should reflect risk associated with effort, e.g. production would normally be lower than development

FPIF - Summary

- **Build FPIF position through a Bottoms-Up approach**
- **Be creative!**
  - **See if contractor's position and government position can fall on same line**
  - **If you're able to write to one position on the line, then the whole line is reasonable**
- **Watch out for split sharelines when trying to put the contractor's and government's position on the same line**